Santee Cooper

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The Honorable John D. Dingell, Ranking Member
Commerce Committee Democratic Office
564 Ford House Office Building
United States House of Representatives
Washington, D.C. 20515

Dear Congressman Dingell:

This is in response to your letter dated April 10, 1997, inviting Santee Cooper to comment upon several issues arising out of the ongoing debate concerning the restructuring of the electric industry. Santee Cooper appreciates the opportunity to participate in this debate and submit these comments. A copy of your April 10, 1997 letter is attached for your use and convenience.

"1. What are your biggest concerns about retail competition? If retail competition has been adopted by the state(s) you service, or is under active consideration, what position have you taken and why?"

Santee Cooper's concerns regarding retail competition can be grouped into two general categories:

1. That Congress or the South Carolina General Assembly will enact restructuring legislation without an adequate factual basis for concluding that retail competition will be fair to all customer groups, and will not compromise current expectations of reliability, economic development and protection of the environment; and

2. That Federal restructuring legislation will not adequately address market power issues.

Regarding the first category of concerns, Santee Cooper has urged both Congress and the South Carolina General Assembly to take a "go slow" approach and learn from the

hand-full of high cost states that have enacted retail choice legislation to date. Once retail choice is instituted on a full scale basis in these states (which has yet to happen), we should have a better idea of whether retail access will in fact work and the pitfalls and advantages of the various approaches to competition that these states are trying.

Regarding the second category of concerns, market power issues must be squarely addressed in any restructuring legislation that is enacted - - - indeed, any legislation which is enacted which does not address this issue could not be called "comprehensive". It is Santee Cooper's impression that market power issues are being given inadequate attention in the ongoing debate over the future structure of the electric industry. The possibility that a few energy providers might be able to dominate the market appears to have been generally discounted; instead, there appears to be almost a blind faith that if Congress deregulates the industry, somehow the market place will make everything work out.

Santee Cooper respectfully submits that in the end "competition" - - - and not "deregulation" - - - will lower the price of energy to all customer classes. However, "competition" by definition requires "competitors". Restructuring legislation that results in an oligopoly of few generators will not produce the desired results.

"2. Do you believe Congress should enact legislation mandating retail competition by a certain date, and why or why not?"

Santee Cooper opposes a federal mandate to implement retail access. Because the rules for retail service have traditionally been the prerogative of the states, the decision whether to permit retail access should likewise be left to the states.

"3. Some privately-owned utilities assert that public power enjoys a broad range of tax-related and other advantages which independently-owned utilities (IOU) do not, and that these would unfairly benefit public power in a competitive retail marketplace. Do you agree? Do IOU's enjoy any benefits public power does not?"

Obviously, private, for-profit electric companies are subject to taxes that don't apply to

public, customer-owned utilities. With that said, the argument that public power somehow enjoys an "advantage" over for-profit utilities in a competitive market place - - - the so-called "level playing field" argument - - - is a red herring that for-profit utilities have thrown into the restructuring debate. The fact of the matter is that private electric companies received huge subsidies from the Federal Government - - - running into the tens of billions of dollars - - - that customer-owned utilities don't enjoy. With these subsidies, for-profit utilities should be more than able to compete with customer-owned utilities in the retail market place.

The extent of the subsidies enjoyed by private, electric companies was recently examined in a report prepared the consulting firm MSB Energy Associates of Middleton, Wisconsin.[1] One of the subsidies studied in that report involved the ability of for-profit utilities to collect federal income taxes from its ratepayers through its rates that are not immediately paid to the U.S. Treasury. This happens when a utility uses different depreciation schedules for tax and ratemaking purposes. For ratemaking purposes, a for- profit utility will use a straight line depreciation method, whereas for tax purposes that utility will typically use whichever accelerated depreciation method might be available to it. The difference between the taxes the for-profit utility collects from its ratepayers and the taxes the utility pays to the U.S. Treasury is recorded on its books as "deferred tax". The utility is able to use this interest free money to finance its utility operations, including domestic merger and foreign utility acquisition activities. In 1994 alone, this particular subsidy cost the U.S. Treasury almost $9 billion. As of 1994, the nation's private power companies were holding more than $57 billion in "deferred taxes" that their ratepayer thought were going to the U.S. Treasury. In our opinion, the level playing field argument advanced by for-profit utilities is nonsense.

"4. If Congress were to mandate retail competition, please provide any recommendations you have with respect to the following issues.

a. *Stranded investment:* However should IOU's stranded investment be treated? Does your company face anything similar and, if so, how should it

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[1] *Major Tax Subsidies to Investor-Owned Electric Utilities and the Cost to the U.S. Treasury, 1994.*

be treated?"

It is reasonable to permit a private, for-profit utility to recover "stranded investment" associated with retail choice. Most utilities, both private and public, have *potential*[2] stranded investment associated with acquiring assets with the expectation that they would be able to pay for those assets from rates calculated using a traditional cost of service methodology.

With that said, a customer-owned utility, such as Santee Cooper, would likely have a different vision of "stranded investment' than a for-profit electric utility. Simply put, unlike a private, for-profit business, Santee Cooper does not have stockholders as such who might be asked to "share" with customers the responsibility for these stranded costs. Instead, Santee Cooper - - - like most other public, customer-owned utilities - - - is able to construct facilities only through the issuance of debt. It is Santee Cooper's position that it has "stranded costs" to the extent that the market price of energy in a price-deregulated environment is less than what is needed both to pay bondholders and meet Santee Cooper's other revenue requirements. (Presently, Santee Cooper designs rates to capture its entire revenue requirement, including debt service.) Neither Santee Cooper nor the State of South Carolina may legally require these bondholders to "share" with customers the responsibility for these stranded costs. Santee Cooper must, therefore, be able to charge rates designed to recover 100% of whatever stranded costs it might have in a price-deregulated environment. If Congress mandates retail competition, customer owned utilities, like Santee Cooper, should be given the opportunity to collect these stranded costs.

"b. *Reciprocity*: Should Congress consider provisions barring access to markets in states which have adopted retail competition by generators in states which have not? Which interests would this affect, and how?"

In the event that Congress enacted legislation mandating retail choice, a reciprocity

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[2]Costs are not "stranded" until the customer is actually served by an alternative energy supplier; until that time, a utility has, at best, *potential* stranded investment.

requirement might have the effect of putting political pressure on legislators in those states that failed to comply with the mandate - - - Santee Cooper certainly understands why Congress would consider such a provision in any federal legislation mandating retail choice.

Still, it is respectfully submitted that it would probably be more prudent to permit each individual state to determine whether it would want to include a reciprocity provision as part of its retail access program. Indeed it is possible that a state might want to forgo placing a reciprocity provision in its retail access program since such a requirement could possibly hurt consumers in that state by cutting off a source of low cost power.

"c. *Local distribution companies (LDC)*: Should Congress require the unbundling of LDC services in order to subject them to competition?"

You seem to be asking two separate questions: 1. Should Congress mandate that utilities unbundle distribution services from a retail customer's bundled rate, *and* 2. Should Congress require integrated electric utilities to corporately disaggregate their distribution assets into a separate legal entity.

Regarding the first of these questions, it is clearly appropriate to unbundle distribution services from a retail customer's bundled rate. Although the distribution system will continue to be a natural monopoly subject to price regulation, it would still be useful to have this reflected as a separate item on the customer's bill, as opposed to being bundled together with the cost to use the transmission system. After all, there are some industrial customers who are able to take service directly from the transmission grid who would not be charged a fee to use the distribution system.

Regarding the second of these questions, it is unclear exactly what purpose would be served by requiring an integrated electric utility to corporately unbundle its distribution assets into a separate legal entity. Since the rates for distribution services would continue to be subject to price regulation, requiring a utility to unbundle these assets would not appear to serve the cause of retail choice whatsoever.

Alternatively, if the purpose of this requirement were to assure that a utility would allow all energy providers comparable access to its distribution system, this could more

easily be accomplished with a requirement of "functional unbundling" of the wires business from the generation business, with a stringent Standard of Conduct imposed on the utility to assure compliance. Indeed, this very same issue was addressed by the Federal Energy Regulatory Commission in Order 888, which introduced competition in the wholesale power market. In that Order, FERC rejected calls that electric utilities be required to corporately unbundle their wholesale merchant functions from their transmission system operations and reliability functions: "We believe that functional unbundling, coupled with these safeguards, is a reasonable and workable means of assuring that non-discriminatory open access transmission occurs. In the absence of evidence that functionally unbundling will not work, we are not prepared to adopt a more intrusive and potentially more costly mechanism - - - corporate unbundling - - - at this time."[3]

Santee Cooper believes that it would be equally unnecessary to mandate corporate disaggregation to effectuate retail access.

Thank you for providing Santee Cooper with the opportunity to participate in the legislative process. Please contact me if you have any questions or if I can be of further assistance.
With personal regards, I am,

Respectfully and sincerely yours,

T. Graham Edwards
President and Chief Executive Officer

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[3]*Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Service by Public Utilities* and *Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, Order No. 888, 61 Fed. Reg. 21, 540 (May 10, 1996).